Dirk Kempthorne, Governor, State of Idaho

RETIREMENT BOARD

Standing: **Dennis L. Johnson,** term expires July 1, 2005; **J. Kirk Sullivan,** term expires July 1, 2006
Sitting: **Susan K. Simmons,** term expires July 1, 2004; **Jody B. Olson,** Chairman, term expires July 1, 2002; **Pamela I. Ahrens,** term expires July 1, 2003

PERSI EXECUTIVE STAFF

Alan H. Winkle, Executive Director
Robert M. Maynard, Chief Investment Officer
John Doner, Deputy Director
James E. Monroe, Financial Officer
Judy Aitken, Field Services Manager
Susan Shaw, Benefits Manager
Becky Crowther, Communications Manager
Carol Boylan, Information Technology Manager
Gay Lynn Bath, Defined Contribution Specialist
Brad Goodsell, Deputy Attorney General

PROFESSIONAL CONSULTANTS

Actuary:	Milliman USA, Inc., Seattle, WA
Auditor:	Deloitte & Touche LLP, Boise, ID
Investment:	Dorn, Helliesen & Cottle, Inc., Boise, ID Chadwick, Saylor & Co., Inc., Atlanta, GA Hamilton Lane Advisors, Philadelphia, PA
Medical:	Dr. John A. Mather, Dr. Bernard P. Strouth, Boise, ID VPA, Inc., Calabasas, CA
Legal:	Calhoun Law Group, Washington, DC Foster, Pepper & Shefelman PLLC, Seattle, WA
Other:	William M. Mercer, Inc., Baltimore, MD
Investment Custodians:	Dreyfus Retirement Services (Mellon Employee Benefit Solutions), Uniondale, NY Mellon Trust, Pittsburgh, PA Wells Fargo Bank of Idaho, Boise, ID
Investment Managers:	Baring Asset Management Co., Inc., Boston, MA Brandes Investment Partners, LP, San Diego, CA Chisholm Partners, Providence, RI Columbus Circle Investors, Inc., Stamford, CT Credit Suisse Asset Management, New York, NY D.B. Fitzpatrick & Co., Boise, ID Full Circle Investments, Erie, PA Furman Selz Investments, New York, NY Galen Partners III Limited, New York, NY Genesis Asset Managers, Ltd., London Goense Bounds & Partners, Lake Forest, IL Harvest Partners, Inc., New York, NY Ida-West, Boise, ID LaSalle Advisors, Ltd., Chicago, IL Lend Lease Rosen, Berkeley, CA Littlejohn Fund, Greenwich, CT McCown DeLeeuw & Co., Menlo Park, CA Mellon Capital Management, San Francisco, CA MFS Institutional Advisors, Inc., Boston, MA Mountain Pacific Investment Advisors, Inc., Boise, ID Oaktree Capital Management, Los Angeles, CA Pareto Partners, London Providence Equity Partners, Inc., Providence, RI Prudential Investments, Newark, NJ Rowe Price International, London Saugatuck Capital Company, Stamford, CT Schroder Capital Management International, London State Street Global Advisors, Boston, MA TCW London International, Ltd., London Tukman Capital Management, Inc., Larkspur, CA Zesiger Capital Group, New York, NY Zurich Scudder Investments, Inc., San Francisco, CA

More specific information on the above-mentioned investment professionals can be found on pages 41 - 43 in the Investment Section of this report.

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Public Employee Retirement System of Idaho

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2000

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

President

Executive Director

ORGANIZATIONAL CHART

Retirement Board

Alan H. Winkle
Executive Director

John Doner
Deputy Director

Brad Goodsell
Deputy Attorney General

Joanne Ax
Administrative Assistant 2

Robert M. Maynard
Chief Investment Officer

Richelle Sugiyama
Investment Officer

Rose Marie Sawicki
Administrative Assistant 1

Investment Managers
See Investment Section for a list of managers – page 41

James E. Monroe
Financial Officer

Rhonda Yadon
Senior Accountant
Cecile McMonigle
Senior Accountant
Barbara Weirick
Financial Unit Supervisor

JoAnne Dieffenbach
Financial Technician
Jodi Hood
Financial Support Technician
Jackie Webb
Financial Technician

Tess Myers
Administrative Assistant 1
Shasta Luper
Office Specialist 1
Sue Zweifel/Alan Roberts
Financial Technician

Jaimie Hiskey
Financial Technician
Alice Brown
Office Specialist 1
Debbie Buck
Financial Technician

Carol Boylan
Information Technology Manager

Stacy Parr
Web Developer
Joy Fereday
IT Programmer Analyst Sr.

Nancy Fauver
IT Database Analyst
Kris Colt
IT Information System Tech Sr.

Tim Thuis
IT Production Specialist
Lance Olson
IT Program Analyst Sr.

Stacy Bussert
IT Program System Specialist

Judy Aitken
Member Services Manager

Lisa Mabe
Member Services Rep
Kari Caven
Member Services Rep
Anna Garlock
Member Services Rep
Susan Strouth
Member Services Rep

Roger Bartlett
Member Services Rep
Jan Murphy
Administrative Assistant 1
Judith Porges
Member Services Rep
Lynn Duncan
Member Services Rep

Lynne Yowell
Administrative Assistant 1
Heidi Andrade
Office Specialist 2
Catherine Atchison
Office Specialist 2
Judy Shock
Administrative Assistant 1

Mary Christensen
Technical Records Specialist 2

Susan Shaw
Benefits Manager

Kay Prince
Technical Records Specialist 1
Lisa Coburn
Technical Records Specialist 2
Shirley Clark
Office Specialist 2
Carrie Mason
Office Specialist 2

Margi Bloom
Customer Service Rep 1
Penny Walls
Technical Records Specialist 2
Melody Hodges
Office Specialist 1

Marian Van Gerpen
Office Specialist 2
Gerry Sjol
Technical Records Specialist 1
Cathy Andrews
Technical Records Specialist 1

Lenna Strohmeyer
Technical Records Specialist 2
Lois Hathorn
Office Specialist 2
Karen Miller
Customer Service Rep 2

Becky Crowther
Public Information Officer

Maxine Thomas
Training Specialist

Bill Duncan
Training Specialist

Betsy Griffith
Administrative Assistant 1

Gay Lynn Bath
Defined Contribution Specialist

Janelle Caitlin
Customer Service Rep 2

THE SYSTEM

The Public Employee Retirement System of Idaho (the System) is the administrator of four pension funds including two defined benefit retirement plans, the Public Employee Retirement "Base Plan" Fund (PERSI) and the Firemen's Retirement Fund (FRF); two defined contribution plans, the Idaho Super Saver, State of Idaho 401(k) Plan and a new PERSI "Choice Plan." In addition, the System administers one agency fund, the Sick Leave/Insurance Reserve Fund.

The Retirement Board consists of five members, each appointed by the Governor to fulfill a five-year term. The Board meets monthly to conduct System business, usually on the fourth Tuesday of each month at 8:30 a.m. at PERSI's Boise office.

Administrative expenditures consisting of the personnel costs, operating expenditures, and capital outlay necessary to operate the System are limited to those approved and appropriated by the Legislature for that purpose. In fiscal year 2001 (FY01), these costs totaled $5,830,224 for the defined benefit retirement plans, including $151,790 in depreciation and $678,063 in amortization expense, which are not cash expenditures and, therefore, not appropriated.

A total of 60 positions comprise the System staff operating from the home office at 607 North 8th Street, Boise, Idaho, and from two field service offices. The Coeur d' Alene office has two staff employees. The Pocatello office has three employees. The Executive Director and investment personnel are exempt positions and are appointed by the Retirement Board to serve at its pleasure. The Deputy Director is in an exempt position serving under the Executive Director. All other staff members serve under statutes and personnel rules governing classified state service.

The System staff oversees the investment of the trust corpus and new contributions with professional investment managers and funding agents. The Retirement Board maintains fiduciary responsibility for investment policy, asset allocation, and the selection of individual investment managers as discussed in the Investment Section.

SUMMARY OF PLAN PROVISIONS

DEFINED BENEFIT "BASE PLAN" PROVISIONS

Note: The items in parentheses are the provisions applicable to members designated as either PERSI firefighters or as police officer members for retirement purposes.

MEMBER CONTRIBUTION RATE

The employee contribution rate is set by statute at 60% (72%) of the employer rate and as of June 30, 2001, was 5.86% (7.21%).

EMPLOYER CONTRIBUTION RATE

The employer contribution rate set by the Retirement Board was 9.77% (10.01%) as of June 30, 2001.

SERVICE RETIREMENT

ELIGIBILITY

Five years of service and age 65 (60, or between 60 and 65, depending on the ratio of police officer/firefighter service to total credited service).

AMOUNT OF ALLOWANCE

For each year of credited service, the monthly service retirement allowance as of June 30, 2001, was 2% (2.3%) of the monthly average salary of the member's highest 42 consecutive months.

MINIMUM MONTHLY BENEFIT ALLOWANCE

Until February 28, 2001: for each year of service, the monthly benefit allowance was $18.47 ($22.16) to a maximum of the member's accrued benefit. Effective March 1, 2001: the monthly benefit allowance was $19.10 ($22.92).

NORMAL FORM

Regular retirement allowance for retiree's life only, plus a lump sum death benefit if retiree dies before allowances are paid, total accumulated employee contributions and interest.

OPTIONAL FORMS
Retirees may also choose 50% or 100% contingent annuitant options, as well as Social Security "bridge" options. These are actuarial equivalents of the normal form based on the mortality and interest assumptions adopted by the Board. The allowance is payable for the life of the retiree and designated contingent annuitant.

EARLY RETIREMENT
ELIGIBILITY
Five years of service and age 55 (50, or between 50 and 55, depending on the ratio of police officer/firefighter service to total credited service).

AMOUNT OF ALLOWANCE
Full accrued service retirement allowance if age plus service, upon separation from employment, total 90 (80, or between 80 and 90, depending on the ratio of police officer/firefighter service to total credited service); otherwise, the accrued service retirement allowance is reduced 3% for each of the first five years by which the early retirement date precedes the date the member would be eligible to receive the unreduced benefit, and by 5.75% for each additional year to a maximum of a second five years. The unreduced benefit entitlement may be either at the service retirement eligibility date or the date eligible for the rule of 90(80).

FORMS
Regular retirement allowance; contingent annuitant allowances for the life of the retiree and a designated contingent annuitant; Social Security level income option for the life of the retiree only or for the life of the retiree and designated survivor.

DISABILITY RETIREMENT
ELIGIBILITY
Active members must have five years of service and must be disabled from any employment. They are eligible from first day on the job if the disability is due to occupational causes.

AMOUNT OF ALLOWANCE
Projected service retirement allowance based on the highest 42 consecutive month average salary at the time of disability. The benefit is calculated using the accrued service at the time of disability plus the service which would have accrued through service retirement age had the disability not occurred. If a member has less than 360 months of service as of the date he is eligible for disability retirement, he will be given credit for the months of service he would have earned from the date the date of disability to the date he would have reached Service Retirement Age (65 for general members/60 for police and firefighters) had he not become disabled (360 months of credited service maximum). In other words, PERSI will give members up to 30 years of credit or to Service Retirement Age, whichever comes first. Monthly allowance is payable after all temporary compensation ceases and is offset by the amount payable as income benefit under worker's compensation law, except when offset by Social Security.

NORMAL FORM
Regular retirement allowance to normal service retirement age when retirement benefit changes to service retirement allowance with its optional forms available.

DEATH BENEFITS
AFTER RETIREMENT
Under the normal form of the retirement allowance, a Social Security adjustment option, or a disability retirement, the balance, if any, of the member's accumulated contributions and interest at retirement over all payments received is paid to the beneficiary in a lump sum. In the case of a disability retirement, the beneficiary may waive the lump sum if the retiree is married so that the spouse will receive a lifetime monthly allowance, or the beneficiary may take a lump-sum payment of two times the amount in the member's account at the time of disability retirement minus any amount paid. Under the contingent annuitant options, the designated annuitant receives a lifetime monthly benefit following the member's death. If the survivor dies before the balance of the member's accumulated contributions and interest has been paid, the balance will be paid to the beneficiary in a lump sum. If the member's designated contingent annuitant predeceases him/her, the member's allowance will be recalculated to a single life payment.

BEFORE RETIREMENT

1 Non-vested Members: Beneficiary receives a lump sum payment of the member's accumulated contributions plus interest.

2 Vested Members:
   a Beneficiary receives a lump sum payment of two times the member's accumulated contributions plus interest.
   b If the member is married, and the spouse is the sole beneficiary, the spouse may select a lump sum payment or a lifetime monthly benefit.
   c If the member is married, but the spouse is not the sole beneficiary, the beneficiary may waive the lump sum, in which case, a lifetime monthly benefit is available to the surviving spouse.

SEPARATION BENEFIT

Accumulated member contributions with regular interest is payable upon becoming an inactive member separated from eligible employment. The Regular Interest Rate in effect for FY01 was 11.11% per year compounded monthly from July 1, 2000 through December 31, 2000, and 12.86% from January 1, 2001 through June 30, 2001.

POSTRETIREMENT ADJUSTMENTS

An annual postretirement adjustment based on and limited by a cost-of-living factor reflecting the changes in the Consumer Price Index (CPI) is effective March of each year. If the CPI change from August of the previous year to August of the second previous year is 1% or more, a 1% mandatory adjustment is made. The Board may authorize additional discretionary adjustments based on the CPI increase (up to a total maximum annual COLA of 6% or the CPI rate, whichever is lower) if it determines that the System can do so and still maintain an appropriately funded position as required by Idaho Code Section 59-1355(1). Adjustments in excess of the 1% authorized by the Board must be reported to the Legislature. If the Legislature has not acted by the 45th day of the legislative session, the COLA becomes effective March 1 of each year.

The Board is also authorized to award postretirement adjustments for prior years in which the actual amount of adjustment was less than the CPI for those years. If the CPI change is downward, in no event will any benefit be reduced below its initial amount.

The COLA authorized and implemented March 1, 2001, was 3.4 %. All PERSI members enjoy 100% purchasing power.

PERSI
Public Employee Retirement System of Idaho

Governor
Dirk Kempthorne

Retirement Board
Jody B. Olson, Chairman
Susan K. Simmons
Dennis L. Johnson
J. Kirk Sullivan
Pamela I. Ahrens

Executive Director
Alan H. Winkle

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November 30, 2001

Dear Governor Dirk Kempthorne, Legislators and Members of the Retirement System:

We are pleased to present to you the Public Employee Retirement System of Idaho (the System) comprehensive annual financial report, for the fiscal year ended June 30, 2001 (FY01). This financial report is a historical perspective of benefits, services, and fiscal activities of the System. Included is a summary of our actuarial valuations, an independent auditor's report, an investment summary, and a statistical section.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to PERSI for its comprehensive annual financial report for the fiscal year ended June 30, 2000. This was the tenth consecutive year that PERSI has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

REPORT STRUCTURE

This FY01 comprehensive annual financial report has five sections: the Introductory Section contains this letter of transmittal plus an overview of the fund; the Financial Section contains the independent auditor's report, the financial statements, and supplementary data; the Investment Section contains the fund's investment performance, strategy, and guidelines; the Actuarial Section contains the consulting actuary's certification letter and a summary of the results of the actuarial valuations and related data; and the Statistical Section contains tables of significant data.

This Letter of Transmittal is intended to serve as an overview of the System and to "transmit" information on the topics below.

PLAN HISTORY

The Public Employment Retirement System of Idaho was created by the Thirty-seventh Legislature, Regular Session of 1963 with funding effective July 1, 1965. It is a tax qualified, defined benefit system to which both the member and the employer contribute. Participation in the System is mandatory for eligible state and school district employees and available to other public employers and their employees on a contractual basis.

When the Teachers Retirement System of Idaho was abolished, members of that system were integrated into PERSI, and all other eligible school district employees became PERSI members effective July 1, 1967.

Legislative amendments since 1965 have made it possible for municipal police officer retirement funds to merge with the System, and two of the five police officer systems have since merged. The other three are being phased out, and police officers hired since 1969 have become members of the System.

Legislation in 1979 mandated that the Firefighter's Retirement Fund be merged with PERSI effective October 1, 1980. Paid firefighters who were members of the original system, retain their original benefit entitlement, while paid firefighters hired after October 1, 1980, are entitled to PERSI benefits. An actuarial valuation of the firefighter member benefit entitlement is conducted at least every other year, separate from the annual PERSI valuation.

In January 2001, PERSI implemented a "Gain Sharing" program as a way to distribute $155 million in excess investment earnings back to our active members, retirees and employer members. Retirees received their gain sharing as a "13th Check." Employers received their share as a contribution "holiday." Some 53,000 eligible active members received their portion as deposits into newly created defined contribution (DC) accounts. This new plan, which is in addition to PERSI's traditional Defined Benefit (DB) "Base" Plan, is called the PERSI "Choice" Plan. It allows employees to actively participate in saving for their retirement.

The Choice Plan is very unique to the public sector. PERSI obtained permission from the Internal Revenue Service to expand a grandfathered State 401(k) to all our members statewide. While some public employees are familiar with 457 or 403(b) plans, a 401(k) is something quite new to them. Many of our members have never had the opportunity to make such pre-tax voluntary contributions. We have the challenge of educating members including teachers, police officers, Fish & Game biologists and more, at different types of employers across the state each with its own hours and methods of employee communications.

SERVICES PROVIDED

The ability of the System to serve both employee and employer members at the local level through the Boise, Pocatello, and Coeur d' Alene offices remains a key factor for efficient administration. The merging of other retirement systems with PERSI, plus statutory amendments over the years, have produced both multiple and diverse member benefit entitlements and administrative requirements. These can best be analyzed and explained to the members through personal contact by knowledgeable System staff members.

In its 36th year of operation, the System continued a wide range of services to the employee and employer members. Members may visit our website, call, e-mail, or stop by one of the three offices for personal information and assistance regarding credited service, account balances, eligibility, benefit options and amounts, and other retirement matters.

Members receive advance notice of service retirement qualification and are provided with estimates of monthly allowances. They also receive information regarding alternate forms of retirement payments available. Retirement applications are processed in a timely fashion, and monthly payments are made promptly. Direct deposit of benefit payments is made available to retired members as is withholding for income tax, medical insurance, or other purposes.

System retirees are provided notices each time their net benefit amount changes. This notice gives the retiree a list of their itemized deductions from their gross benefit.

Separation and death benefits are paid in an orderly manner and as rapidly as possible. In some instances payments are expedited to avoid financial hardship on a member.

Employee contributions and earned interest are posted to individual member accounts each month, and an annual statement is provided to each member confirming their average monthly salary, credited service, contributions, and earned interest. In addition, a report of benefits accrued to date is provided along with an estimate of benefits projected ahead to various retirement ages.

The staff of employer units responsible for reporting and handling retirement transactions and activities is provided training and assistance through monthly bulletins and personal contact by field service personnel on a regular basis and as needed. Employer records and reporting procedures are reviewed each year for accuracy and compliance with statutory provisions.

Upon request, public employers interested in affiliation with the System are counseled and provided with information regarding employee benefits, cost and procedures associated with joining. Conversely, employers considering withdrawal are provided information and employee benefit projections to enable them to make an informed decision.

Pre-Retirement and Financial Planning Workshops are offered around the state covering financial planning, budgeting, investment basics, as well as Social Security and System benefits.

EMPLOYEE AND EMPLOYER MEMBERSHIP

During FY01, the number of active PERSI members increased from 60,388 to 62,125. The number of retired members or annuitants receiving monthly allowances increased from 22,456 to 23,253. The number of inactive members who have not been paid a separation benefit increased from 18,497 to 18,723. Of these inactives, 6,585 have achieved vested eligibility. Total membership in PERSI increased from 101,341 to 104,101 during the fiscal year. There are currently 645 public employers in Idaho who are PERSI members. Participating employers are listed in the statistical section of this report.

FINANCIAL MANAGEMENT

The financial statements and supplemental schedules included in this report are the responsibility of System management and have been prepared in accordance with generally accepted accounting principles for governmental accounting and reporting as pronounced or adopted by the Governmental Accounting Standards Board.

INDEPENDENT AUDIT

The System is audited annually, and for the fiscal year ended June 30, 2001, the audit was conducted by Deloitte & Touche LLP, an independent firm of Certified Public Accountants. Refer to the Independent Auditors' Report for the opinion.

INTERNAL ACCOUNTING CONTROL

As an agency of the State of Idaho, the System's administrative expenses are subject to the State's budget controls. Management is responsible for maintaining a system of internal accounting control designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization and are recorded as needed to maintain accountability for assets to permit preparation of financial statements. An internal control procedure has been established, and a budget report is prepared for the Board. We believe the internal controls in effect during FY 2001 adequately safeguard the assets and provide reasonable assurance regarding the proper recording of financial transactions.

FINANCIAL HIGHLIGHTS

Collection of employer and employee contributions, as well as income and gains from investments, provides the reserves necessary to finance retirement benefits. These income sources totaled ($149,185,253) for all funds during the fiscal year ended June 30, 2001.

ADDITIONS:	
Contributions	$ 316,555,167
INVESTMENT INCOME:	
Net Appreciation (Depreciation) in Fair Value of Investments	(669,224,044)
Interest, Dividends and Other Investment Income	228,806,992
Less: Investment Expenses	(25,710,110)
Net Investment Income (Loss)	(466,127,162)
OTHER INCOME	386,742
Total Additions	($ 149,185,253)

The payment of benefits is the primary expense of a retirement system. The payments, together with the expenses to administer the Plan, constitute the total expenses of the System. Expenses for the System for FY01 are as follows:

DEDUCTIONS:

Benefits and Refunds	$ 287,936,887
Administrative Expenses	5,874,271
Transfers Out	57,024,773
Total Deductions	$ 350,835,931

Revenue and expenses continue to increase at a predictable rate. Investment income reflects changes in asset allocation, as well as overall market conditions.

AMOUNT SHOWN BELOW AS ACTUARIAL PRESENT VALUE OF FUTURE BENEFITS

Future benefits include all benefits estimated to be payable to plan members (retirees and beneficiaries, terminated employees entitled to benefits but not yet receiving them, and current active members) as a result of their service through the valuation date and their expected future salary. The actuarial present value of future benefits as of the valuation date is the present value of the cost to finance benefits payable in the future, discounted to reflect the expected effects of the time value (present value) of money and the probabilities of payment. Expressed another way, it is the amount that would have to be invested on the valuation date so that the amount invested plus investment earnings will provide sufficient assets to pay total future benefits when due.

The actuarial present value was calculated as part of an actuarial valuation at July 1, 2001. Significant actuarial assumptions used include: a rate of return on the investment of present and future assets of 8.0% compounded annually, (7.5% plus 0.5% for expenses); projected salary increase of 5.25% per year compounded annually, attributable to general wage increases; additional projected salary increases up to 4.0% per year, depending on age and employee classification, attributable to seniority/merit, and; 1.0% per year attributable to postretirement benefit increases.

At June 30, 2001, the unfunded actuarial liability on a current contribution basis was as follows:

Unfunded Actuarial Liability on Current Contribution Basis (in millions):

	Valuation Date:	July 1, 2001
	Benefit Date:	July 1, 2001
A. Actuarial Present Value of All Future Benefits for Contributing Members, Former Contributing Members and Their Survivors		$ 9,790.0
B. Actuarial Present Value of Total Future Normal Costs for Present Members		3,038.7
C. Actuarial Liability [A - B]		6,751.3
D. ORP Contributions		72.2
E. Actuarial Liability Funded by PERSI Contributions [C-D]		6,679.1
F. Actuarial Value of Assets Available for Benefits		6,492.8*
G. Unfunded Actuarial Liability (funding excess) [E-F]		$ 183.3
H. Amortization Period on Valuation Date, Based on Contribution Rate Established as of Benefit Date		10.2 Years
I. Funded Ratio [F/E]		97.2%**

* The total available assets are $6,715.3 million, but are reduced by $222.5 million for assets used in plan operations and funds earmarked to provide excess benefits to former members of the Firefighter's Retirement Fund.

** The discretionary COLA of 1.7% to begin on March 1, 2002 (assuming legislative approval), reduces the funded ratio by .6% from 97.2% to 96.6%.

ECONOMIC CONSIDERATIONS

The System operates within a dynamic economic environment, as do all investment funds. The objective of the Retirement Board is to minimize the effect of these external influences, where possible, by diversifying among a broad range of asset classes and investment management styles, both domestically and internationally. Such diversification, combined with prudent management by experienced investment professionals, increases the probability that the earnings objective will be achieved. The return for fiscal year 2001 was –6.48% net of expenses.

The Public Employee Retirement System of Idaho is funded on a sound actuarial basis, which protects future benefits for participants. Over the long-term, the Plan's assets should achieve their expected returns. However, short-term shortfalls in earnings targets could occur in unfavorable economic environments and/or unfavorable actuarial experience. As of June 30, 2001 the fund had an amortization period of 10.2 years.

INVESTMENT STRATEGY AND POLICIES

The Retirement Board utilizes and directs funding agents to provide whatever investment management and custodial functions best achieve the System's investment objectives. The Board establishes asset allocation policy, diversification guidelines, custodial functions including safe-guarding of investments, and other investment restrictions. Each money manager is generally granted full discretion in making investment decisions within their guidelines. The Board, staff, and consultants monitor and evaluate investment results. The Board, in its administration of this System and management of the investment program, is guided by the fiduciary standards in Section 59-1301 of the Idaho Code and the Idaho Uniform Prudent Investor Act, in Sections 68-501 through 68-514 of the Idaho Code and is empowered in its sole discretion to limit, control, and designate the types, kinds, and amounts of investments. Current year investment information and return can be found in the Investment Section of this report.

MAJOR INITIATIVES

GAIN SHARING

This is a new, valuable benefit for active members, retirees and employers. In years when PERSI is overfunded, we may share excess earnings with these three groups through gain sharing. Gain sharing is in addition to current benefits. Other benefits will not change. Gain sharing could mean $50 to $200 million or more is shared with members and employers in any given year. In 2001, our first year for granting gain sharing, we distributed $155.4 million among active members, retirees and employers. For individuals, gain sharing could range from several hundred to several thousand dollars each year.

How Gain Sharing Works

The fiscal year-end date is used to determine PERSI's funding level for the year. The Retirement Board determines if PERSI's funding is adequate to handle all benefit payments and other expenses. Their decision takes several factors into account: How much did PERSI's investments earn during the year? How much did PERSI's liabilities grow during the year? Is there enough funding to absorb any normal fluctuations in the stock market? How is the economic outlook for the coming year? Were there any legislative changes to the Plan during the year that affect funding?

Generally, if funding is stable and there are no major liability or legislative changes to PERSI in a particular year, our investments would need to earn over 8% per year for gain sharing to occur.

The Board is highly motivated to grant gain sharing whenever possible, but as fiduciaries responsible for ensuring the stability of the fund, they have the authority to withhold gain sharing in any year they determine it is not prudent to make distributions. With the poor investment climate during FY01, there will be no gain sharing in FY02.

How Much Members May Receive

For active members, gain sharing may mean several hundred or several thousand dollars each year, depending upon PERSI's funding and their Base Plan account balances. For retirees, it could mean a one-time payment of one to three times their monthly benefit in one check. The IRS currently limits payments to active members to a maximum of 25% of gross salary or $30,000, whichever is lower.

For employers, gain sharing could mean a significant annual credit toward some or all of the contributions to PERSI for a particular year.

When Gain Sharing Distributions Will Occur
Gain sharing may or may not occur every year. The Board will make a determination each year. Distributions, if any, will be paid the following January.

How Gain Sharing is Distributed to Active Members
In February 2001, PERSI set up individual Defined Contribution (DC) Choice accounts for all eligible active members. In years when there is excess funding, PERSI will make a deposit into these new Choice accounts. Most active members now have two PERSI accounts - their PERSI Defined Benefit (DB) Base account, and their DC Choice account.

An active member's gain sharing allocation is based on his or her account balance in the PERSI Base Plan. They have the option of investing the gain sharing in the PERSI Total Return Fund, with an asset allocation mirroring the Base Plan portfolio, or other offered investment choices. They may also make additional voluntary contributions to the Choice account (subject to IRS limits). Active members must have 12 months of membership service and must be an active member at the end of the fiscal year (June 30) to be eligible for gain sharing for that year.

Members who are active and eligible for gain sharing as of June 30 and quit work but leave their money in PERSI, will receive a gain sharing deposit (if any) in January. However, if members terminate work and withdraw their PERSI money before the January payout, they cease being a member, and therefore will not receive gain sharing.

As PERSI had only ten months to develop and implement the gain sharing and new Choice Plan program, once the gain sharing legislation was passed, implementation was done in phases.

- Members received their distributions into their new accounts on February 1, 2001.
- Beginning in May 2001, members were able to begin actively managing their funds. Members may choose to leave their funds in the PERSI Total Return Fund, or they may transfer their funds among ten additional investment options.
- In July 2001, members were allowed to begin voluntary contributions to the Plan through tax-deferred payroll deductions. (Note: this is dependent on the ability of the 645 individual employers to accept voluntary contributions. Employers have a grace period to make payroll system changes before they are required to allow voluntary contributions.)

Members cannot withdraw their gain sharing money or voluntary contributions to the Choice account unless they terminate work or retire.

How Gain Sharing is Distributed to Retirees
Retirees receive a gain sharing allocation based on their current PERSI Base benefit. Payment is a one-time payment in addition to their January monthly benefit (a "13th check"). This one-time payment may occur each year, depending on how well investments do. Retirees continue to receive annual Cost of Living Adjustments (COLAs) each March. Gain sharing is in addition to the COLAs.

Members who are active on June 30 and retire after that, will be eligible for gain sharing (if any) as active members that year but will receive that payment as a 13th check. The next year they would be retirees on June 30, so they would receive a payment (if any) under the retiree process.

Inactive Members do NOT Receive Gain Sharing
The law states that members must be active on June 30 and have 12 months of service to be eligible for gain sharing.

How Gain Sharing works for Employers
Employers will receive their allocation in the form of a credit toward contributions payable during the following calendar year. The allocation will be based on the amount of their contributions to PERSI the previous fiscal year compared to all employer contributions to the Plan.

REGULAR INTEREST

Since January 1, 2000, the Regular Interest Rate credited to member accounts has been equal to PERSI's net investment return rate. The rate for each calendar year is based on the annual net rate of return at the end of the previous fiscal year (June 30). The interest rate is effective January 1 of each year based on investment performance for the fiscal year ending the previous June 30. Should the investment return for any fiscal year be less than the yearly average of 90-day Treasury Bills, regular interest will be at least equal to that T-bill average. Although PERSI experienced negative returns in FY01, the regular interest rate paid to members effective January 1, 2002 will be 4.82%.

ACKNOWLEDGMENTS

This financial report of the Public Employee Retirement System of Idaho was prepared by staff under the leadership of the Retirement Board. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship for the assets contributed by the members and their employers.

This report is being sent to the Governor, State Legislators, and other interested parties.

Respectfully submitted,

(Jody B. Olson Signature) *(Alan H. Winkle Signature)* *(James E. Monroe Signature)*

Jody B. Olson, Chairman
Alan H. Winkle, Executive Director
James E. Monroe, Financial Officer